FitchRatings

20 DEC 2024

Fitch Downgrades SBB Parent's IDR to 'CCC'; Unsecured Debt to 'CC'; Maintains Rating Watch Negative

Fitch Ratings - Frankfurt am Main - 20 Dec 2024: Fitch Ratings has downgraded SBB - Samhällsbyggnadsbolaget i Norden AB's (SBB Parent) Long-Term Issuer Default Rating (IDR) to 'CCC' from 'CCC+' and its senior unsecured debt rating to 'CC'/RR6 from 'CCC+'/RR4. Both ratings remain on Rating Watch Negative (RWN). A full list of rating actions is below.

The rating actions reflect the transfer of SBB Parent's real estate assets and, following a recent offer to bondholders, the bulk of the group's liabilities to its subsidiary Samhallsbyggnadsbolaget i Norden Holding AB (publ) (SBB Holding). This weakens SBB Parent's credit profile, whose main SEK3.2 billion of assets cannot meaningfully support its SEK19 billion of retained debt. These assets are attached to its secured debt and are not available to SBB Parent's predominantly unsecured bondholders.

The RWNs incorporate tight liquidity and the SBB Parent-contested formal claim of a covenant breach in 2022, which is currently proceeding in the UK courts. If the courts decide that a covenant breach did occur this could result in an event of default (EofD). Depending on the relevant bondholders' response, such an outcome may result in a further downgrade.

Key Rating Drivers

Bulk of Bonds Exchanged: SBB Parent made a voluntary cash tender offer for its unsecured bonds maturing in 2025, repayable in cash, and a voluntary exchange offer for its unsecured bonds maturing between 2026 and 2029, at par, with unchanged coupons and maturity dates with new bonds issued by SBB Holding. The tender prepaid only about SEK1.3 billion of 2025 debt maturities, and cancelled SEK0.7 billion of SBB Parent-held bonds. The remaining 2025 maturity bonds of SEK4.7 billion will remain at SBB Parent. The SBB group's liquidity is sufficient to meet these 2025 debt maturities.

The completed exchange offer saw SEK32 billion of 2026 to 2029 debt transferred to SBB Holding as unsecured bonds. These new exchanged bonds are also guaranteed by SBB Parent. Unsecured bondholders who remain with SBB Parent or SBB Treasury Oyj (whose debt is guaranteed by SBB Parent), totalling about SEK7.7 billion (including 2025 debt maturities), are now structurally subordinated to creditors in SBB Holding following the transaction. Some SEK8.6 billion of hybrids also remain at SBB Parent.

Unsecured Creditors' Assets Insufficient: About SEK3.2 billion of income-producing assets retained at SBB Parent are pledged to specific SEK2.4 billion of secured debt. To fund its retained 2025 debt maturities, an intergroup instrument exists with SBB Holding, who holds the bulk of group cash.

Rental income is insufficient to service SBB Parent's retained debt and will rely on cash upstreamed from SBB Holding to meet interest payments and redeem maturities due in 2026 and beyond. Headroom exists under SBB Holding's unsecured bond covenants to allow upstreaming of cash (or restricted distributions, as defined in bond documentation) to SBB Parent.

Options to Raise Liquidity: SBB Parent, on its own, does not have many options to raise cash to repay bonds maturing in 2026 and beyond. Liquidity will need to be raised at SBB Holding through various options at its disposal, including asset sales, sale of retained joint venture stakes, raising external capital on its remaining wholly-owned community service portfolio, possibly through asset-backed transactions similar to the Castlelake JVs, forming another strategic partnership, issuing an IPO, and upstreaming cash within available covenant headroom.

Weakened Credit Profile: SBB Parent's rating is driven by its small asset base and insufficient rental income generation, which translates into less than 1x EBITDA net interest cover, despite the continuing deferral of hybrid interest. Fitch differentiates SBB Parent's weakened credit profile from its stronger subsidiary, SBB Holding, and the structural subordination of its bondholders by rating SBB Parent one notch below SBB Holding's IDR.

Lower Unsecured Debt Recoveries: The Recovery Ratings on the remaining senior unsecured instruments are adversely affected by SBB Parent's minimal asset base. Fitch estimates minimal to no recoveries for unsecured bondholders at SBB Parent in a default, which translates into a 'RR6' Recovery Rating. This analysis does not attribute any value to its various investments in equity stakes, including Public Property Invest AS (BBB/Stable).

Hybrids Lose Equity Credit: SBB's exchange offer shows that SBB Parent no longer views hybrids a long-term component of its capital structure. The transfer has resulted in EUR327 million of SBB Parent's hybrids being converted into unsecured debt of EUR154 million (SEK1.8 billion) at SBB Holding. Fitch therefore no longer applies equity credit to the SEK8.6 billion hybrid bonds retained by SBB Parent, due to their lack of permanence under Fitch's "Corporates Hybrids Treatment and Notching Criteria", and these non-performing instruments are rated 'C', three notches below the IDR.

EofD Claim Continues: SBB Parent continues to face the risk of an EofD if the UK high court rules in favour of the formal claim by a sole bondholder of an interest coverage covenant breach tested in 2022. However, a final decision may not be reached until end-1H25. In recent weeks, SBB Parent has received letters from more bondholders expressing their intention to accelerate, which it views as ineffective. Fitch understands from management that if EofD-claiming bondholders have exchanged their bonds, they will not hold SBB Parent bonds when they appear in court in January 2025.

Derivation Summary

The SBB group's stable Nordic property portfolio is supported by the education and community service properties' stable tenant base with long-term indexed leases. This is tempered by the regional location of some assets within the group's portfolio. The SBB group also owns residential-for-rent assets, including 56% of Sveafastigheter AB, which owns SEK27.8 billion of residential assets.

Within the community service portfolio, Assura plc (A-/Negative) builds and owns modern general practitioners' facilities in the UK, with approved rents indirectly paid by the state National Health Service and a similar 11.2 years weighted average unexpired lease term (WAULT). At GBP2.7 billion (EUR3.2 billion), its portfolio is much smaller than the SBB group's. Reflecting Assura's community service activities, its net initial yield as of September 2023 was 5% versus SBB's 5.3% for its Nordic community service assets at end-2023. Assura has a 99% occupancy rate and specific-use assets. Assura's downgrade rating sensitivity to 'BBB+' includes net debt/EBITDA greater than 9x.

The smaller EUR0.8 billion portfolio of higher-rated Norwegian-based Public Property Invest ASA (PPI; BBB/Stable) is community service-focused also with public sector tenants. PPI's business profile is, however, paired with a stronger balance sheet with net debt/EBITDA below 8x, loan-to-value around 45% and an interest cover around 2x.

Under Fitch's EMEA Real Estate Navigator, many of the SBB group's portfolio-focused factors are investment-grade.

Key Assumptions

Fitch's Key Assumptions Within Our Rating Case for the Issuer

-- Moderate rental growth of 3.5% per year, driven by CPI-indexation and rental uplifts

-- Stable net rental income margins

-- Hybrid interest deferred

Recovery Analysis

Our recovery analysis assumes that SBB Parent would be liquidated rather than restructured as a going-concern (GC) in a default.

Recoveries are based on the end-3Q24 independent valuation of its investment property portfolio. Fitch has used SBB Parent's retained property's values of around SEK3.2 billion, to which it has applied a standard 20% discount. Fitch has used SBB Parent's updated retained unsecured and subordinated hybrid debt amounts, after some bonds were exchanged into bonds at SBB Holding.

We assume no cash is available for recoveries. This analysis attributes zero value to various investments in equity stakes, including the SEK1.9 billion attributable value of Public Property Invest AS's equity.

After deducting a standard 10% for administrative claims, we assume that no unencumbered investment property assets are available to unsecured creditors. Existing directly-held investment property is dedicated to SEK2.4 billion secured creditors who rank ahead of SBB Parent's unsecured creditors.

Fitch's principal waterfall analysis generates a ranked recovery for senior unsecured debt of 'RR6', which is equivalent to a waterfall-generated recovery computation output percentage of 0% based on current metrics and assumptions. The 'RR6' indicates a 'CC' unsecured debt instrument rating.

Given the structural subordination of SBB Parent's hybrids, we estimate a ranked recovery of 'RR6' with 0% expected recoveries. As loss-absorption has been triggered with deferral of coupons, the instrument rating is 'C', three notches below SBB Parent's IDR.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Failure to execute, or provide visibility, of a plan to address the retained euro-denominated (SEK465 million-equivalent) September 2026 debt maturity at least 12 months in advance

- Actions pointing to a widespread potential renegotiation of SBB Parent's debt's terms and conditions, including a material reduction in lenders' terms sought to avoid a default

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Evidence that refinancing risk has eased, including improved capital markets receptivity to the SBB group

- A material reduction in leverage

Liquidity and Debt Structure

SBB Parent's available liquidity at end-3Q24 was SEK1.5 billion. Most of SBB Parent's group cash including SEK3.1 billion Sveafastigheter IPO proceeds, are now held at SBB Holding. SBB Parent uses an intergroup loan mechanism to repay its 2025 debt maturities with cash at SBB Holding. SBB Parent also has access to an undrawn SEK2.5 billion asset asset-backed facility held at SBB Holding. It has no revolving credit facilities available for drawdown.

The next debt material maturity, following the potential repayment of its retained 2025 bonds, is its euro-denominated (SEK465 million-equivalent) bond in September 2026. SBB Parent's average cost of debt at end-3Q24 was 2.3%, excluding hybrids (averaging 3.3%) and the higher-coupon Morgan Stanley preference shares (13% coupon) in SBB Residential Property AB.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG Considerations

SBB Parent has an ESG Relevance Score of '4' for Governance Structure to reflect previous key person risk (the previous CEO) and continuing different voting rights among shareholders affording greater voting rights to the key person. SBB Parent has an ESG Relevance Score '4' for Financial Transparency, reflecting an ongoing investigation by the Swedish authorities into the application of accounting standards and disclosures. Both these considerations have a negative impact on the credit profile, and are relevant to the ratings in conjunction with other factors. These factors are, however, improving under the new SBB management.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT		RATING		RECOVERY	PRIOR
SBB - Samhallsbyggnadsbolaget i Norden AB	LT IDR	CCC ⬙	Downgrade		CCC+ ⬙
	ST IDR	C ⬙	Rating Watch Maintained		C ⬙
• senior unsecured	LT	CC ⬙	Downgrade	RR6	CCC+ ⬙
• subordinated	LT	C	Affirmed	RR6	C
• senior unsecured	ST	C ⬙	Rating Watch Maintained		C ⬙
SBB Treasury Oyj					
• senior unsecured	LT	CC ⬙	Downgrade	RR6	CCC+ ⬙

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◈	◆
STABLE	▣	

Applicable Criteria

Corporate Hybrids Treatment and Notching Criteria (pub.12 Nov 2020)

Corporate Rating Criteria (pub.06 Dec 2024) (including rating assumption sensitivity)

Corporate Recovery Ratings and Instrument Ratings Criteria (pub.02 Aug 2024) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub.06 Dec 2024)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

SBB - Samhallsbyggnadsbolaget i Norden AB	EU Issued, UK Endorsed
SBB Treasury Oyj	EU Issued, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch’s website.

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